

Message Text

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ACTION EB-07

INFO OCT-01 EA-07 ISO-00 AID-05 TRSE-00 CIAE-00
COME-00 FRB-03 INR-07 NSAE-00 USIA-06 XMB-02
OPIC-03 SP-02 LAB-04 EPG-02 SIL-01 OMB-01 NSC-05
SS-15 STR-04 CEA-01 FEA-01 AGRE-00 L-03 H-01
/081 W

-----109272 281108Z /14

R 280845Z JUN 77

FM AMEMBASSY JAKARTA

TO SECSTATE WASHDC 2032

INFO USDOC WASHDC

AMCONSUL HONG KONG

AMEMBASSY KUALA LUMPUR

AMEMBASSY MANILA

AMEMBASSY SINGAPORE

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DEPT PASS AID

HONG KONG FOR TREASURY REP.

E.O. 11652: N/A

TAGS: EFIN, ID

SUBJECT: INDONESIA'S ECONOMY CONTINUES STRONG PERFORMANCE

1. PERFORMANCE OF INDONESIAN ECONOMY CONTINUES TO BE STRONG. GOI RECENTLY ANNOUNCED BALANCE OF PAYMENTS SURPLUS OF \$1 BILLION IN FY 1976-7 (APRIL - MARCH31). LATEST BANK INDONESIA WEEKLY REPORT (JUNE 16) SHOWS NET FOREIGN EXCHANGE RESERVES IN MID-MAY OF \$2.15 BILLION, MORE THAN FIFTY PERCENT IMPROVEMENT OVER RESERVE LEVEL OF \$1.3 BILLION AT END OF DECEMBER. CYCLICAL MOVEMENT IN INDONESIA'S RESERVE LEVEL OWING TO LARGE OIL COMPANY PAYMENTS AT BEGINNING OF EACH QUARTER TENDS TO OVERSTATE SOMEWHAT
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DECEMBER-MID-MAY INCREASE BUT AFTER ALLOWING FOR THIS DISTORTION, GROWTH IN RESERVES IS SIGNIFICANT IMPROVEMENT OVER NEAR CRITICAL LOW RESERVE LEVEL OF 1975 (\$437 MILLION IN THIRD QUARTER OF 1975).

2. RESERVES HAVE GROWN PRIMARILY BECAUSE OF CONTINUED STRONG EXPORT PERFORMANCE AND GREATER DISCIPLINE RE-

GARDING SHORT AND LONG TERM FOREIGN BORROWING. VALUE OF OIL EXPORTS DURING FIRST THREE MONTHS OF 1977 HAVE TOTALED \$1.7 BILLION UP 19 PERCENT OVER SAME THREE MONTH PERIOD YEAR EARLIER. GROWTH IN NON-OIL EXPORTS IS EVEN STRONGER WITH EXPORTS OVER FIRST FOUR MONTHS TOTALING \$928 MILLION AS COMPARED WITH \$606 MILLION A YEAR EARLIER. IMPORT FIGURES (BASED ON LETTERS OF CREDIT APPLICATIONS) EVEN FOR FIRST TWO MONTHS OF 1977 APPEAR TO BE INCOMPLETE SO NO COMPARISONS CAN BE MADE WITH PREVIOUS YEAR.

3. THE GOI IS CONTINUING TO EXPERIENCE PROBLEMS IN KEEPING INFLATION UNDER CONTROL. OVER THE FIRST FIVE MONTHS OF 1977, INFLATION, AS MEASURED BY THE JAKARTA COST OF LIVING INDEX, HAS RISEN AT AN ANNUAL RATE OF ABOUT 12 PERCENT. ALTHOUGH THIS IS AN IMPROVEMENT OVER THE 14.2 PERCENT RATE RECORDED IN 1976 AND THE 19.7 PERCENT RATE IN 1975, THE GOVERNMENT IS DOUBTLESS DISAPPOINTED INASMUCH AS THE ANNUAL RATE OVER THE FIRST QUARTER WAS DOWN TO AROUND 10 PERCENT BUT CLIMBED IN APRIL AND MAY AS A RESULT OF FOOD PRICE INCREASES.

4. GROWTH IN THE MONEY SUPPLY (M1) HAS CONTRIBUTED STRONGLY TO INFLATIONARY PRESSURES. IN 1977, THROUGH THE FIRST TWO WEEKS OF MAY, THE MONEY SUPPLY GREW 17 PERCENT, A RATE OF GROWTH WHICH, IF CONTINUED OVER THE COURSE OF LIMITED OFFICIAL USE

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A FULL YEAR, WOULD LEAD TO A MONEY SUPPLY INCREASE OF OVER 40 PERCENT. GROWTH IN NEW FOREIGN ASSETS (\$860 MILLION) WAS DOMINANT ELEMENT IN MONEY SUPPLY INCREASE SINCE SUBSTANTIAL REDUCTION IN BANK INDONESIA CREDIT TO CENTRAL GOVERNMENT (\$440 MILLION) MORE THAN OFFSET ALL OTHER FACTORS AFFECTING SUPPLY OF MONEY.

5. COMMENT: ALTHOUGH GOI MANAGEMENT OF MONEY SUPPLY AND INFLATION SHOW MARKED IMPROVEMENT OVER PAST YEARS, IT STILL LEAVES SOMETHING TO BE DESIRED. IMPRESSIVE EXPORT PERFORMANCE AND CONSEQUENT GROWTH IN RESERVES HAS CLEARLY PUT ECONOMY BACK ON ITS FEET FOLLOWING PERTAMINA CRISIS OF 1975/6. PRESENT LEVEL OF RESERVES ARE EQUIVALENT TO NEARLY THREE MONTHS' IMPORTS AT ANTICIPATED IMPORT RATES. WHILE THIS RESERVE LEVEL AFFORDS INDONESIA SOME WELCOME BREATHING SPACE AFTER VERY TIGHT SITUATION YEAR AGO, LEVEL ITSELF CAN CERTAINLY BE REGARDED AS LITTLE MORE THAN BARE MINIMUM COUNTRY REQUIRES IN PRESENT CIRCUMSTANCES, PARTICULARLY IN VIEW OF FACT THAT \$1 BILLION OF RESERVES, IN EFFECT, REPRESENTS MONEY BORROWED TWO YEARS AGO FROM U.S. AND JAPANESE BANKING SYNDICATES AS BALANCE OF PAYMENTS COVER. GIVEN THE SENSITIVITY OF INDONESIA'S EXPORTS TO

WORLD DEMAND AND HEAVY DEBT SERVICE REQUIREMENTS GOI
FACES OVER NEXT THREE YEAR PERIOD, INDONESIAN AUTHORITIES
WILL PROBABLY SEEK FURTHER INCREASES IN RESERVE LEVEL
BEFORE THEY CONSIDER THEY HAVE ADEQUATE CUSHION IN EVENT
EXPORTS DECLINE.

6. THERE CONTINUES TO BE SPECULATION AS TO WHETHER GOI
WILL GO TO CAPITAL MARKET ANYTIME SOON TO REFINANCE ALL OR
PART OF BALANCE OF PAYMENTS LOANS TAKEN OUT TWO YEARS
AGO. FEELING IS THAT GIVE INTERNATIONAL LIQUIDITY SITU-
ATION AND IMPROVED STATE OF INDONESIA'S ECONOMY, IF GOI
WERE TO SEEK REFINANCING, IT COULD ALMOST CERTAINLY COMMAND
BETTER TERMS THAN IT OBTAINED DURING HEIGHT OF PERTAMINA
CRISIS AND REFINANCING WOULD HELP SMOOTH OUT PEAKING
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IN 1979/80 IN GOI'S DEBT SERVICE OBLIGATIONS. ALTHOUGH GOI
IS NO DOUBT REVIEWING THIS POSSIBILITY, THERE IS LITTLE
EVIDENCE THAT IT INTENDS TO GO TO THE MARKET, IN ANY
BIG WAY AT LEAST, OVER NEXT FEW MONTHS.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC GROWTH, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Sent Date: 28-Jun-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977JAKART08505
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770230-0348
Format: TEL
From: JAKARTA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770611/aaaaajnv.tel
Line Count: 141
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 72199e73-c288-dd11-92da-001cc4696bcc
Office: ACTION EB
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 3
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 11-Feb-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2011699
Secure: OPEN
Status: NATIVE
Subject: INDONESIA'S ECONOMY CONTINUES STRONG PERFORMANCE
TAGS: EFIN, ECON, ID
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/72199e73-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009